

NOVATO SANITARY DISTRICT

October 26, 2010

The regular meeting of the Board of Directors of Novato Sanitary District, scheduled for 6:30 p.m., Monday, October 25, 2010, has been cancelled.

The Board will hold a special meeting at 1:00 p.m., Tuesday, October 26, 2010, at the District offices, 500 Davidson Street, Novato.

Materials related to items on this agenda are available for public inspection in the District Office, 500 Davidson Street, Novato, during normal business hours. They are also available on the District's website: www.novatosan.com.

AGENDA

1. PLEDGE OF ALLEGIANCE:

2. AGENDA APPROVAL:

3. PUBLIC COMMENT (Please observe a three-minute time limit):

This item is to allow anyone present to comment on any subject not on the agenda, or to request consideration to place an item on a future agenda. Individuals will be limited to a three-minute presentation. No action will be taken by the Board at this time as a result of any public comments made.

4. BOARD MEMBER REPORTS:

5. REVIEW OF MINUTES:

- a. Consider approval of minutes of the October 11, 2010 meeting.

6. CONSENT CALENDAR:

The Manager-Engineer has reviewed the following items. To her knowledge, there is no opposition to the action. The items can be acted on in one consolidated motion as recommended or may be removed from the Consent Calendar and separately considered at the request of any person.

- a. Meeting schedule – November 8th and 22nd, December 13th and 27th, January 10th and 24th.
- b. Approval of disbursements.

7. 2009-10 AUDITED FINANCIAL STATEMENTS:

- a. Presentation of Audited Financial Statements for fiscal year ended June 30, 2010, by Paul Kaymark, Charles Z. Fedak & Company.

8. RIBBON CUTTING CEREMONY FOR UPGRADED TREATMENT PLANT:

- a. Briefing and program for ribbon cutting ceremony.

9. MANAGER'S ANNOUNCEMENTS:

10. ADJOURNMENT:

Next resolution no. 3028

In compliance with the Americans with Disabilities Act, if you need special assistance to participate in this meeting, please contact the District at (415) 892-1694 at least 24 hours prior to the meeting. Notification prior to the meeting will enable the District to make reasonable accommodation to help ensure accessibility to this meeting.

Sigrid Boehm
24 Brooke Circle
Mill Valley CA 94941
415 388-3410
goosemom4ever@gmail.com

October 16, 2010

To the Board of Directors
Novato Sanitary District
500 Davidson Street
Novato, CA 94945
Attention: Sandeep Karkal

Ladies and Gentlemen:

Ms. June was kind enough to call me a few days after the September 27th meeting which I attended, but what she told me I already knew and that was not the reason for my attending the board meeting.

I am reiterating: I feel it is not fair to only have 3 tiers in charging homeowners for sewerage, based on water consumption.

From what I understand the

first tier goes from 0 - 2,392 gal water consumption
second tier from 2,393 - 18,848 gal water consumption
and anything beyond is automatically charged as the third tier.

So whether my consumption was 18,900 gal or 79,300 gal the sewerage charge would be the same on my property tax bill. My charge on the current tax bill is \$833.60 for my rental property in Novato.

I herewith like to appeal this billing system. I suggest a third tier from 18,848 to approximately 35,300 and then a fourth tier for any consumption beyond that. That would be fairer to the homeowner.

Thank you

Sincerely

Sigrid Boehm

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NOVATO SANITARY DISTRICT

October 11, 2010

A regular meeting of the Board of Directors of the Novato Sanitary District was held at 6:30 p.m., Monday, October 11, 2010, at the District Office, 500 Davidson Street, Novato.

BOARD MEMBERS PRESENT: President William C. Long, Members James D. Fritz, Michael Di Giorgio, George C. Quesada and Dennis Welsh.

STAFF PRESENT: Deputy Manager-Engineer Sandeep Karkal, Administrative Services Manager June Brown and Administrative Secretary Julie Borda.

STAFF ABSENT: Manager-Engineer Beverly B. James.

ALSO PRESENT: Dan Macdonald, President, Daniel Macdonald Architects
SB Crow

PLEDGE OF ALLEGIANCE:

AGENDA APPROVAL:

On motion of Member Quesada, seconded by Member Di Giorgio, and carried unanimously, the agenda was approved as mailed.

PUBLIC COMMENT:

None.

BOARD MEMBER REPORTS:

Member Fritz commented on an article in the Marin Independent Journal regarding the North Marin Water District and Novato's potential growth.

Member Quesada commented on the "no growth" efforts Marin County attempted to enforce in the past.

Member Welsh commented on a homeowner who brought her concerns to the September 27th Board meeting regarding sanitary sewer service rates and the need for a fourth tier to be introduced to the fee structure. He questioned if the District office had resolved her concerns.

The Deputy Manager-Engineer said that the homeowner had called the office earlier in the day of September 27th and had spoken to staff member Robin Merrill regarding her water usage. He explained that Mr. Merrill had reviewed the water usage with the homeowner that day, but she felt it necessary to come before the Board to request

introduction of a fourth tier. The Deputy Manager-Engineer stated that subsequently the Administrative Services Manager had discussed the matter further with the homeowner and had asked her to write a letter to the District Board regarding her request for implementation of a fourth tier. The Deputy Manager-Engineer stated that the District had not yet received a letter from the homeowner.

Member Welsh said that the homeowner had contacted North Marin Water District because there had been a water leak on her property which resulted in an unusually high amount of water usage for a specific period and the Water District had adjusted her bill to allow for the leak. Member Welsh requested the District adjust her sewer service charge as well. The Deputy Manager-Engineer noted that even after the District allowed for the water leak, the water usage for the subject property was still in the high use category. Member Welsh then asked how many of the District's users fall in the high use category. The Administrative Services Manager and the Deputy Manager-Engineer responded that approximately 6% of Novato residents fall into the third tier (high water use category).

President Long commented that the Board has discussed in the past refining of the three tier billing system as well as possibly integrating resident's sanitary sewer service charges with their North Marin Water District billing.

President Long stated he had spoken to the Manager-Engineer and requested she prepare a presentation for the Board which would review the incidents that led up the fines from the Regional Board for the Collection Systems overflows.

REVIEW OF MINUTES:

Consider approval of minutes of the September 13th and 27th, 2010 meeting.

On motion of Member Di Giorgio, seconded by Member Fritz, and carried with the following vote, the minutes of the September 13th and 27th, 2010 Board meeting were approved. Ayes: Di Giorgio, Fritz, Quesada, Welsh. President Long abstained due to his absence from the September 27th meeting.

CONSENT CALENDAR:

On motion of Member Di Giorgio, seconded by Member Long and carried unanimously, the following Consent Calendar item was approved:

- a. Approval of regular disbursements in the amount of \$638,789.27, project account disbursements in the amount of \$635,421.05, Board member disbursements in the amount of \$2,204.97 and ratification of payroll and payroll related expenses for September, 2010 in the amount of \$248,362.61.

Member Welsh questioned the disbursement to Sideman & Bancroft, LLP. He said that his understanding was that the EPA investigation had ended and commented that his recollection was that the District had requested the law firms involved in the EPA investigation to cease investigative measures in April 2010. The Deputy Manager-Engineer explained the time lag in receiving invoices and noted also that the attorneys would need some time to finalize their bills.

President Long requested the Manager-Engineer arrange with District Counsel to prepare a reconciliation of the attorneys' fees for the matter relating to the EPA investigation.

ADMINISTRATION BUILDING UPGRADE PROJECT 73003:

- Presentation of solar evaluation: The Deputy Manager-Engineer introduced Dan Macdonald of Daniel Macdonald Architects, the firm which had designed the current District administration building. Mr. Macdonald presented a PowerPoint illustration to demonstrate alternative methods to achieve solar shading for the Manager-Engineers corner office of the administration building. In addition, Mr. Macdonald discussed and presented studies his firm completed to determine the use/location of solar panels. Mr. Macdonald's presentation included various scenarios for the placement of architectural shading, proposed solutions for each scenario and their costs. He noted that an architectural space frame solar shading unit would cost approximately \$30,000 and that photo voltaic (solar) panels would vary in cost. Mr. Macdonald stated he would assist the District in analyzing costs for the panels and look at possible subsidies from other agencies that encourage the incorporation of photo voltaic panels.

The Deputy Manager-Engineer stated that the Manager-Engineer was looking for direction from the Board on the concept to provide shading through exterior structures and/or shade plantings, or through interior banners.

The Board discussed the size and placement of photo voltaic panels. President Long stated that the Board was interested in moving forward with the idea but wished to seek more information regarding the costs.

Member Long suggested that the New Facility Committee review the information further but stated he felt the shading solutions should be acted upon as soon as possible.

SPECIAL DISTRICT REPRESENTATION ON MARIN COUNTY LOCAL AGENCY FORMATION COMMISSION:

- Consider nomination of candidates for alternate Special District representation on Marin LAFCO to fill unexpired term of Fred Hannahs: President Long asked if any of the Board members would like to be nominated for the vacant position on the Marin LAFCO board. There were no nominations made and President Long announced the Board would pass.

BOARD OF DIRECTORS:

- Appointment of an Ad Hoc Audit Committee. The Deputy Manager-Engineer noted that the Ad Hoc Audit committee would hold their first meeting on Tuesday, October 19th at 5:30 PM and would meet with District auditor Paul Kaymark of Charles Z. Fedak & Company.

President Long appointed Members Welsh and Fritz to the Ad Hoc Audit committee.

- Appointment of an Ad Hoc Labor Negotiations Committee. The Deputy Manager-Engineer stated that the current Memorandum of Understanding (MOU) with Teamsters will expire on December 31, 2010 and the District is entering into negotiations for the new MOU.

President Long appointed himself and Member Di Giorgio to form the Ad Hoc Labor Negotiations Committee.

TREATMENT PLANT UPGRADE PROJECT 72609:

- Treatment Plant ribbon cutting program – give direction to staff. President Long pointed out that the Treatment Plant ribbon cutting ceremony is scheduled for Tuesday, October 26th, beginning at 2PM. The Board discussed the event details with the Deputy Manager-Engineer and gave direction to proceed with planning for the event.

STAFF REPORTS:

- Regional Monitoring Program. The Deputy Manager-Engineer discussed the Regional Monitoring Program in which the District participates. He noted that the San Francisco Estuary Institute annually publishes a summary of their findings in a report titled "Pulse of the Estuary" and a copy was included in each Board Members agenda packet on October 11th.

MANAGER'S ANNOUNCEMENTS:

None.

ADJOURNMENT IN MEMORY OF ARTHUR KNUTSON, DIRECTOR 1982 TO 2009:

On motion of Member Di Giorgio, seconded by Member Fritz, and carried unanimously, the Board adjourned the meeting of October 11th in memory of Novato Sanitary District Director Arthur Knutson.

There being no further business to come before the Board, President Long declared the meeting adjourned at 7:40 PM.

Respectfully submitted,

Sandeep Karkal
Deputy Manager Engineer

Julie Borda, Recording

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Novato Sanitary District
Check Register
 October 25, 2010

Date	Num	Name	Credit
Oct 25, 10			
10/25/2010	51860	Pacific, Gas & Electric	78,711.83
10/25/2010	51867	Sonoma County Water Agency	61,256.00
10/25/2010	51834	Covello Group, The	41,198.00
10/25/2010	51856	Nute Engineering Inc.	33,848.10
10/25/2010	51861	PSC	31,062.76
10/25/2010	51830	California Diesel & Power	11,637.21
10/25/2010	51865	Roy's Sewer Service, Inc.	9,440.00
10/25/2010	51849	Miller Pacific Engineering, Inc.	9,275.70
10/25/2010	51846	Law Office of Miranda Kane	6,705.50
10/25/2010	51853	North Marin Water District	5,857.10
10/25/2010	51848	Marin/Sonoma Mosquito Dist	5,318.42
10/25/2010	51863	Rauch Communication Consultants. Inc.	4,943.75
10/25/2010	51835	Daniel Macdonald AIA Architects, Inc.	4,565.43
10/25/2010	51832	CDW Government, Inc.	3,856.58
10/25/2010	51826	American Express-22062	3,365.87
10/25/2010	51864	RMC Water & Environment, Inc.	3,245.00
10/25/2010	51823	Aerotek	2,941.50
10/25/2010	ACH	Bowens, Kenneth	2,910.00
10/25/2010	51831	CDPH - Environmental Laboratory Accred	2,811.00
10/25/2010	51825	Alliant Insurance Services, Inc	2,601.00
10/25/2010	51872	Water Environmnet Research Foundation	1,936.00
10/25/2010	51844	Kaiser Permanente-Cobra	1,737.35
10/25/2010	51839	G & K Services	1,377.18
10/25/2010	51843	Kaiser Permanente	1,242.69
10/25/2010	51866	Siemens Water Tech Corp.	682.50
10/25/2010	51847	Marin County Public Health Lab	630.00
10/25/2010	51842	Johnson Controls, Inc.	607.00
10/25/2010	51858	Oratech Controls, Inc.	572.62
10/25/2010	51833	Clarence & Dyer LLP	532.29
10/25/2010	51845	Labworks Equipment, Inc.	437.50
10/25/2010	51850	MME	362.59
10/25/2010	51822	3T Equipment Company Inc.	324.85
10/25/2010	51855	Novato Chevrolet	314.78
10/25/2010	51840	Ikon Office Solutions	302.64
10/25/2010	51871	Water Components & Building	287.07
10/25/2010	51852	North Marin Auto Parts	267.59
10/25/2010	51827	B.W.S. Distributors, Inc.	217.39
10/25/2010	51828	BoundTree Medical, LLC	204.49
10/25/2010	51836	Datco Billing Inc.	163.80
10/25/2010	51869	VWR International Inc.	148.67
10/25/2010	51870	WasteManagement	141.29
10/25/2010	51868	Verizon California	117.71
10/25/2010	51841	Interstate Batteries	108.56
10/25/2010	51851	North Bay Portables, Inc.	89.70
10/25/2010	51824	Alhambra	85.42
10/25/2010	51859	Orkin Pest Control	80.45
10/25/2010	51838	Don Johnsons Pool Service	40.31
10/25/2010	51854	Novato Car Wash	35.17
10/25/2010	51857	One Stop Auto Service Inc.	33.80
10/25/2010	51837	Department Of Motor Vehicles	23.00

10/22/10

Novato Sanitary District Check Register

October 25, 2010

<u>Date</u>	<u>Num</u>	<u>Name</u>	<u>Credit</u>
10/25/2010	51862	Radio Shack	6.51
10/25/2010	51829	VOID	0.00
Oct 25, 10			<u><u>338,661.67</u></u>

10/22/10

Novato Sanitary District Check Register

October 25, 2010

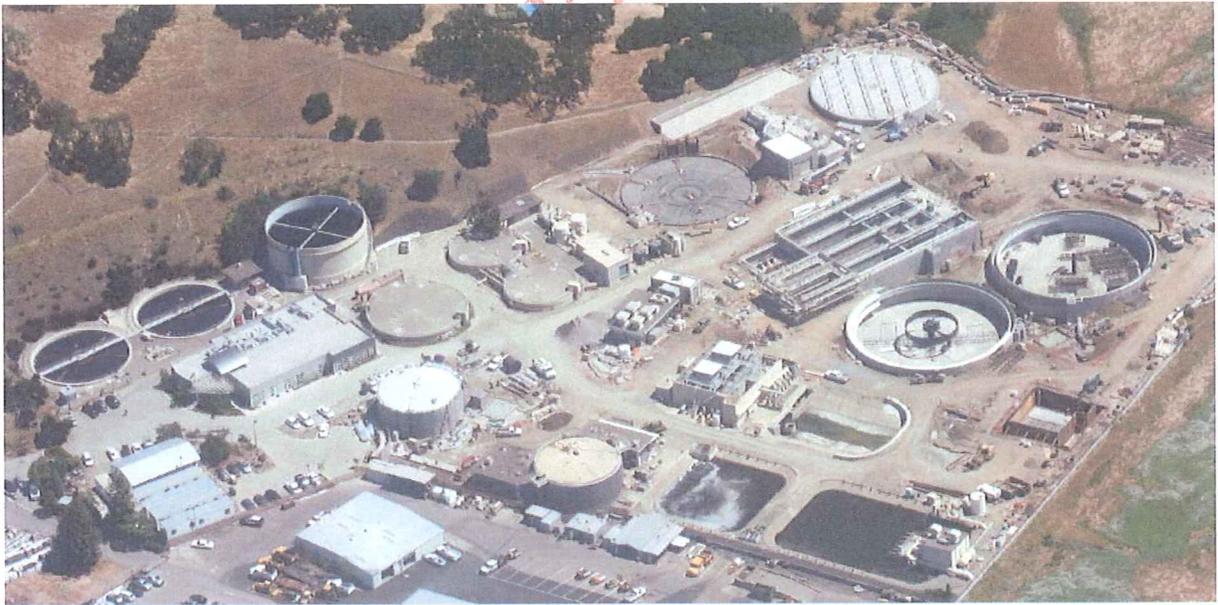
<u>Date</u>	<u>Num</u>	<u>Name</u>	<u>Credit</u>
Oct 25, 10			
10/25/2010	2098	Covello Group, The	133,993.25
10/25/2010	2102	Maggiora & Ghilotti Inc.	70,615.24
10/25/2010	2103	W.R. Forde	25,200.00
10/25/2010	2099	DW Pumps LLC	1,573.99
10/25/2010	2100	Empire Mini Storage - Novato	730.00
10/25/2010	2101	ModSpace Corporation	411.50
Oct 25, 10			<u>232,523.98</u>



Novato Sanitary District

Annual Financial Report

For the Fiscal Years Ended June 30, 2010 and 2009



Leaders in Protecting the Environment

Novato Sanitary District provides wastewater collection, treatment, and disposal services for the community of Novato, California. In addition, the District is responsible for refuse disposal, recycling, and greenwaste collection through its franchise collector, Novato Disposal Service.

Novato Sanitary District Board of Directors as of June 30, 2010

<u>Name</u>	<u>Title</u>	<u>Elected/ Appointed</u>	<u>Current Term</u>
William C. Long	President	Elected	12/09-12/13
James D. Fritz	President Pro-Tem	Elected	12/07-12/11
Michael Di Giorgio	Director	Elected	12/09-12/13
George C. Quesada	Director	Elected	12/07-12/11
Dennis J. Welsh	Director	Elected	12/09-12/13

**Novato Sanitary District
Beverly James, General Manager
500 Davidson Street
Novato, California 94945
(415) 892-1694 – www.novatosan.com**

Novato Sanitary District

Annual Financial Report

For the Fiscal Years Ended June 30, 2010 and 2009

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**Novato Sanitary District
Annual Financial Report
For the Fiscal Years Ended June 30, 2010 and 2009**

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Financial Section

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Independent Auditor's Report

Board of Directors
Novato Sanitary District
Novato, California

We have audited the accompanying financial statements of the Novato Sanitary District (District) as of and for the year ended June 30, 2010, which collectively comprise the District's basic financial statements as listed in the table of contents. These basic financial statements are the responsibility of the District's management. Our responsibility is to express an opinion on these basic financial statements based on our audits. The comparative financial information as of June 30, 2009 was audited by other auditors whose report dated March 24, 2010, expressed an unqualified opinion on those financial statements.

We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the basic financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the basic financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall basic financial statement presentation. We believe that our audit provide a reasonable basis for our opinion.

In our opinion, the basic financial statements referred to above present fairly, in all material respects, the respective financial position of the Novato Sanitary District as of June 30, 2010, and the respective changes in net assets and cash flows for the year then ended in conformity with accounting principles generally accepted in the United States of America.

In accordance with *Government Auditing Standards*, we have also issued a report dated September 18, 2010, on our consideration of the District's internal control over financial reporting and our tests of its compliance with certain provisions of laws, regulations, contracts, grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be read in conjunction with this report in considering the results of our audit. This report can be found on page 27.

Management's discussion and analysis on pages 2 through 5 and the required supplemental information on page 22 are not required parts of the basic financial statements but are supplementary information required by the Governmental Accounting Standards Board. We have applied certain limited procedures, which consisted primarily of inquiries of management regarding the methods of measurement and presentation of the required supplementary information. However, we did not audit this information and express no opinion on it.

September 18, 2010
Cypress, California

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Novato Sanitary District
Management's Discussion and Analysis
For the Years Ended June 30, 2010 and 2009

The following Management's Discussion and Analysis (MD&A) of activities and financial performance of the Novato Sanitary District (District) provides an introduction to the financial statements of the District for the fiscal year ended June 30, 2010 and 2009. The two year presentation is provided for comparative purposes. We encourage readers to consider the information presented here in conjunction with the basic financial statements and related notes, which follows this section.

Financial Highlights

- The District's net assets increased 3.4% or \$3,802,615 to \$111,346,297 in fiscal year 2010.
- The District's operating revenues increased 8.7% or \$1,123,568 in 2010 due primarily from the 2009 fiscal year sewer service charge increase of \$40 per year per account which yielded a \$1,176,011 increase in the sewer service charge revenue.
- The District's operating expenses before depreciation increased 25.6% or \$1,969,062 in 2010 primarily due to the tremendous increase in legal fees incurred towards the ongoing EPA investigation since May 2009. (See notes 14 and 15 for further information)

Required Financial Statements

This annual report consists of a series of financial statements. The Statement of Net Assets, Statement of Revenues, Expenses and Changes in Net Assets and Statement of Cash Flows provide information about the activities and performance of the District using accounting methods similar to those used by private sector companies.

The Statement of Net Assets includes all of the District's investments in resources (assets) and the obligations to creditors (liabilities). It also provides the basis for computing a rate of return, evaluating the capital structure of the District and assessing the liquidity and financial flexibility of the District. All of the current year's revenue and expenses are accounted for in the Statement of Revenues, Expenses and Changes in Net Assets. This statement measures the success of the District's operations over the past year and can be used to determine if the District has successfully recovered all of its costs through its rates and other charges. This statement can also be used to evaluate profitability and credit worthiness. The final required financial statement is the Statement of Cash Flows, which provides information about the District's cash receipts and cash payments during the reporting period. The Statement of Cash Flows reports cash receipts, cash payments and net changes in cash resulting from operations, investing, non-capital financing, and capital and related financing activities and provides answers to such questions as where did cash come from, what was cash used for, and what was the change in cash balance during the reporting period.

Financial Analysis of the District

One of the most important questions asked about the District's finances is, "Is the District better off or worse off as a result of this year's activities?" The Statement of Net Assets and the Statement of Revenues, Expenses and Changes in Net Assets report information about the District in a way that helps answer this question.

These statements include all assets and liabilities using the *accrual basis of accounting*, which is similar to the accounting method used by most private sector companies. All of the current year's revenues and expenses are taken into account regardless of when the cash is received or paid.

These two statements report the District's *net assets* and changes in them. You can think of the District's net assets – the difference between assets and liabilities – as one way to measure the District's financial health, or *financial position*. Over time, *increases or decreases* in the District's net assets are one indicator of whether its *financial health* is improving or deteriorating. However, one will need to consider other non-financial factors such as changes in economic conditions, population growth, zoning and new or changed government legislation, such as changes in Federal and State wastewater standards.

Novato Sanitary District
Management's Discussion and Analysis
For the Years Ended June 30, 2010 and 2009

Notes to the Basic Financial Statements

The notes provide additional information that is essential to a full understanding of the data provided in the basic financial statements. The notes to the basic financial statements can be found on pages 10 through 26.

Statement of Net Assets

Condensed Statements of Net Assets

	<u>2010</u>	<u>2009</u>	<u>Change</u>
Assets:			
Current assets	\$ 14,729,450	33,390,384	(18,660,934)
Non-current assets	16,744	35,433	(18,689)
Capital assets, net	<u>182,646,429</u>	<u>157,063,808</u>	<u>25,582,621</u>
Total assets	<u><u>197,392,623</u></u>	<u><u>190,489,625</u></u>	<u><u>6,902,998</u></u>
Liabilities:			
Current liabilities	10,287,583	34,789,710	(24,502,127)
Non-current liabilities	<u>75,758,743</u>	<u>48,156,233</u>	<u>27,602,510</u>
Total liabilities	<u><u>86,046,326</u></u>	<u><u>82,945,943</u></u>	<u><u>3,100,383</u></u>
Net assets:			
Net investment in capital assets	102,065,015	79,067,990	22,997,025
Unrestricted	<u>9,281,282</u>	<u>28,475,692</u>	<u>(19,194,410)</u>
Total net assets	<u><u>111,346,297</u></u>	<u><u>107,543,682</u></u>	<u><u>3,802,615</u></u>
Total liabilities and net assets	<u><u>\$ 197,392,623</u></u>	<u><u>190,489,625</u></u>	<u><u>6,902,998</u></u>

As noted earlier, net assets may serve over time as a useful indicator of a government's financial position. In the case of the District, assets of the District exceeded liabilities by \$9,281,282 and \$28,475,692 as of June 30, 2010 and June 30, 2009, respectively.

By far the largest portion of the District's net assets (92% and 74% as of June 30, 2010 and 2009, respectively) reflects the District's investment in capital assets (net of accumulated depreciation) less any related debt used to acquire those assets that is still outstanding. The District uses these capital assets to provide services to customers within the District's service area; consequently, these assets are not available for future spending.

At the end of fiscal years 2010 and 2009, the District showed a positive balance in its unrestricted net assets of \$9,281,282 and \$28,475,692, respectively, which may be utilized in future years. See note 9 for further discussion.

Novato Sanitary District
Management's Discussion and Analysis
For the Years Ended June 30, 2010 and 2009

Statement of Revenues, Expenses and Changes in Net Assets

Condensed Statements of Revenues, Expenses and Changes in Net Assets

	<u>2010</u>	<u>2009</u>	<u>Change</u>
Revenues:			
Operating revenues	\$ 14,071,716	12,948,148	1,123,568
Non-operating revenues	<u>2,119,105</u>	<u>2,783,272</u>	<u>(664,167)</u>
Total revenues	<u>16,190,821</u>	<u>15,731,420</u>	<u>459,401</u>
Expenses:			
Operating expenses	9,654,452	7,685,390	1,969,062
Depreciation and amortization	2,288,892	2,227,627	61,265
Non-operating expenses	<u>2,169,519</u>	<u>1,432,369</u>	<u>737,150</u>
Total expenses	<u>14,112,863</u>	<u>11,345,386</u>	<u>2,767,477</u>
Net income before capital contributions	<u>2,077,958</u>	<u>4,386,034</u>	<u>(2,308,076)</u>
Capital contributions	<u>1,724,657</u>	<u>1,042,803</u>	<u>681,854</u>
Change in net assets	<u>3,802,615</u>	<u>5,428,837</u>	<u>(1,626,222)</u>
Net assets, beginning of year	<u>107,543,682</u>	<u>102,114,845</u>	<u>5,428,837</u>
Net assets, end of year	<u>\$ 111,346,297</u>	<u>107,543,682</u>	<u>3,802,615</u>

The statement of revenues, expenses and changes of net assets shows how the District's net assets changed during the fiscal years. In the case of the District, net assets increased by \$3,802,615 and \$5,428,837 for the fiscal years ended June 30, 2010 and 2009, respectively.

A closer examination of the sources of changes in net assets reveals that:

The District's operating revenues increased 8.7% or \$1,123,568 in 2010 due primarily from the 2009 fiscal year sewer service charge increase of \$40 per year per account which yielded a \$1,176,011 increase in the sewer service charge revenue.

The District's operating expenses before depreciation increased 25.6% or \$1,969,062 in 2010 primarily due to the tremendous increase in legal fees incurred towards the ongoing EPA investigation since May 2009.

Capital Asset Administration

At the end of fiscal year 2010 and 2009, the District's investment in capital assets amounted to \$182,646,429 and \$157,063,808 (net of accumulated depreciation), respectively. This investment in capital assets includes land, land improvements, sewer collection and outfall system, buildings and structures, equipment, vehicles and construction-in-process, etc. Major capital assets additions during the year include improvements to portions of the District's sewer collection and treatment system. (See note 5 for further details)

Novato Sanitary District
Management's Discussion and Analysis
For the Years Ended June 30, 2010 and 2009

Capital Asset Administration, continued

Changes in capital assets amounts for 2010 were as follows:

	<u>Balance 2009</u>	<u>Additions</u>	<u>Transfers/ Deletions</u>	<u>Balance 2010</u>
Capital assets:				
Non-depreciable assets	\$ 60,183,890	27,815,084	(3,308,336)	84,690,638
Depreciable assets	137,506,174	4,274,318	(1,318,231)	140,462,261
Accumulated depreciation and amortization	<u>(40,626,256)</u>	<u>(2,288,892)</u>	<u>408,678</u>	<u>(42,506,470)</u>
Total capital assets ,net	<u>\$ 157,063,808</u>	<u>29,800,510</u>	<u>(4,217,889)</u>	<u>182,646,429</u>

Changes in capital assets amounts for 2009 were as follows:

	<u>Balance 2008</u>	<u>Additions</u>	<u>Transfers/ Deletions</u>	<u>Balance 2009</u>
Capital assets:				
Non-depreciable assets	\$ 26,614,040	34,385,057	(815,207)	60,183,890
Depreciable assets	136,199,622	1,611,222	(304,670)	137,506,174
Accumulated depreciation and amortization	<u>(38,619,457)</u>	<u>(2,227,627)</u>	<u>220,828</u>	<u>(40,626,256)</u>
Total capital assets ,net	<u>\$ 124,194,205</u>	<u>33,768,652</u>	<u>(899,049)</u>	<u>157,063,808</u>

Debt Administration

Changes in long-term debt amounts for 2010 were as follows:

	<u>Balance 2009</u>	<u>Additions</u>	<u>Deletions</u>	<u>Balance 2010</u>
Long-term debt:				
Note payable	\$ 30,006,231	-	(24,773,024)	5,233,207
Loan payable	<u>47,989,587</u>	<u>27,358,620</u>	<u>-</u>	<u>75,348,207</u>
Total long-term debt	<u>\$ 77,995,818</u>	<u>27,358,620</u>	<u>(24,773,024)</u>	<u>80,581,414</u>

Changes in long-term debt amounts for 2009 were as follows:

	<u>Balance 2008</u>	<u>Additions</u>	<u>Deletions</u>	<u>Balance 2009</u>
Long-term debt:				
Note payable	\$ 30,006,231	-	-	30,006,231
Loan payable	<u>21,691,826</u>	<u>26,297,761</u>	<u>-</u>	<u>47,989,587</u>
Total long-term debt	<u>\$ 51,698,057</u>	<u>26,297,761</u>	<u>-</u>	<u>77,995,818</u>

Conditions Affecting Current Financial Position

Management is unaware of any conditions which could have a significant impact on the District's current financial position, net assets or operating results based on past, present and future events.

Requests for Information

This financial report is designed to provide the District's funding sources, customers, stakeholders and other interested parties with an overview of the District's financial operations and financial condition. Should the reader have questions regarding the information included in this report or wish to request additional financial information, please contact the District's General Manager at 500 Davidson Street, Novato, California, 94945.

Basic Financial Statements

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Novato Sanitary District
Statements of Net Assets
June 30, 2010, with Comparative Information as of June 30 2009

<i>Assets</i>	2010	2009
Current assets:		
Cash and cash equivalents (note 3)	\$ 10,997,695	32,661,934
Restricted – cash and cash equivalents (note 3 and 14)	167,132	166,520
Accrued interest receivable	44,771	139,659
Accounts receivable – sewerage services	195,126	74,302
Accounts receivable – governmental agencies	411,611	147,680
Accounts receivable – loan proceeds	2,627,431	-
Accounts receivable – other, net	216,049	199,754
Property tax receivable	10,786	535
Prepaid expenses and other deposits	58,849	-
Total current assets	<u>14,729,450</u>	<u>33,390,384</u>
Non-current assets:		
Deferred charges, net (note 4)	16,744	35,433
Capital assets – not being depreciated (note 5)	84,690,638	60,183,890
Capital assets, net – being depreciated (note 5)	<u>97,955,791</u>	<u>96,879,918</u>
Total non-current assets	<u>182,663,173</u>	<u>157,099,241</u>
Total assets	<u>\$ 197,392,623</u>	<u>190,489,625</u>
<i>Liabilities and Net Assets</i>		
Current liabilities:		
Accounts payable and accrued expenses	\$ 2,373,853	3,129,873
Customer deposits and deferred revenue	83,648	163,942
Restricted – special assessment payable (note 14)	167,132	166,520
Accrued interest payable	2,387,310	1,267,595
Long-term liabilities – due within one year:		
Compensated absences (note 6)	42,433	55,549
Note payable (note 7)	<u>5,233,207</u>	<u>30,006,231</u>
Total current liabilities	<u>10,287,583</u>	<u>34,789,710</u>
Non-current liabilities:		
Long-term liabilities – due in more than one year:		
Compensated absences (note 6)	127,300	166,646
Other post-employment benefits payable (note 8)	283,236	-
Loan payable (note 7)	<u>75,348,207</u>	<u>47,989,587</u>
Total non-current liabilities	<u>75,758,743</u>	<u>48,156,233</u>
Total liabilities	<u>86,046,326</u>	<u>82,945,943</u>
Net assets: (note 9)		
Investment in capital assets, net of related debt	102,065,015	79,067,990
Unrestricted	<u>9,281,282</u>	<u>28,475,692</u>
Total net assets	<u>111,346,297</u>	<u>107,543,682</u>
Total liabilities and net assets	<u>\$ 197,392,623</u>	<u>190,489,625</u>

See accompanying notes to the basic financial statements

Novato Sanitary District
Statements of Revenues, Expenses and Changes in Net Assets
For the Fiscal Year Ended June 30, 2010,
With Comparative Information for the Fiscal Year Ended June 30, 2009

	<u>2010</u>	<u>2009</u>
Operating revenues:		
Sewerage service charges	\$ 13,462,437	12,286,426
Other service charges	300,817	287,716
Permit, inspection and other fees	23,163	27,408
Recycled water facility	8,000	74,736
AB939 – solid waste programs	277,299	271,862
Total operating revenues	<u>14,071,716</u>	<u>12,948,148</u>
Operating expenses:		
Collection system	828,832	599,787
Treatment plant	3,102,119	3,017,245
Wastewater reclamation and disposal	296,268	411,778
Laboratory and monitoring	597,743	537,069
Sewers and pump stations	540,641	332,808
Recycled water facility	-	74,736
AB939 – solid waste programs	284,999	286,682
Administrative and engineering	4,003,850	2,425,285
Total operating expenses	<u>9,654,452</u>	<u>7,685,390</u>
Operating income before depreciation	4,417,264	5,262,758
Depreciation and amortization	<u>(2,288,892)</u>	<u>(2,227,627)</u>
Operating income	<u>2,128,372</u>	<u>3,035,131</u>
Non-operating revenue(expense)		
Property taxes	1,866,049	1,928,207
Franchise fees	45,000	45,000
Rental revenue	-	82,517
Interest earnings	196,303	702,002
Interest expense	(1,211,880)	(1,302,270)
Deferred charges amortization	(18,689)	(18,689)
Loss on sale/disposition of capital assets	(909,553)	(83,842)
Other non-operating revenues	11,753	25,546
Other non-operating expenses	<u>(29,397)</u>	<u>(27,568)</u>
Total non-operating, net	<u>(50,414)</u>	<u>1,350,903</u>
Net income before capital contributions	<u>2,077,958</u>	<u>4,386,034</u>
Capital contributions:		
Connection fees	1,277,790	647,101
Capital contributions	446,867	395,702
Total capital contributions	<u>1,724,657</u>	<u>1,042,803</u>
Change in net assets	<u>3,802,615</u>	<u>5,428,837</u>
Net assets, beginning of year	107,543,682	113,375,768
Prior period adjustment	<u>-</u>	<u>(11,260,923)</u>
Net assets, end of year	<u>\$ 111,346,297</u>	<u>107,543,682</u>

See accompanying notes to the basic financial statements

Novato Sanitary District
Statements of Cash Flows
For the Fiscal Year Ended June 30, 2010,
With Comparative Information for the Fiscal Year Ended June 30, 2009

	2010	2009
Cash flows from operating activities:		
Cash receipts from customers for water sales and services	\$ 13,682,419	12,889,706
Cash paid to employees for salaries and wages	(2,327,199)	(3,877,890)
Cash paid to vendors and suppliers for materials and services	(8,020,427)	(4,612,350)
Net cash provided by operating activities	3,334,793	4,399,466
Cash flows from non-capital financing activities:		
Property taxes	1,855,798	1,928,207
Franchise fees	45,000	45,000
Rental revenue	-	82,517
Net cash provided by non-capital financing activities	1,900,798	2,055,724
Cash flows from capital and related financing activities:		
Acquisition and construction of capital assets	(28,781,066)	(35,181,072)
Capital contributions	1,724,657	1,042,803
Proceeds received from loan payable	24,731,189	26,297,761
Principal payments on note payable	(24,773,024)	-
Interest payments on note payable	(92,165)	(419,439)
Net cash used in capital and related financing activities	(27,190,409)	(8,259,947)
Cash flows from investing activities:		
Interest earnings	291,191	746,119
Net cash provided by investing activities	291,191	746,119
Net decrease in cash and cash equivalents	(21,663,627)	(1,058,638)
Cash and cash equivalents, beginning of year	32,828,454	33,887,092
Cash and cash equivalents, end of year	\$ 11,164,827	32,828,454
Reconciliation of cash and cash equivalents to statement of financial position:		
Cash and cash equivalents	\$ 10,997,695	32,661,934
Restricted – cash and cash equivalents	167,132	166,520
Total cash and cash equivalents	\$ 11,164,827	32,828,454

Continued on next page

See accompanying notes to the basic financial statements

Novato Sanitary District
Statements of Cash Flows, continued
For the Fiscal Year Ended June 30, 2010,
With Comparative Information for the Fiscal Year Ended June 30, 2009

	2010	2009
Reconciliation of operating income to net cash provided by operating activities:		
Operating income	\$ <u>2,128,372</u>	<u>3,035,131</u>
Adjustments to reconcile operating income to net cash provided by operating activities:		
Deprecation and amortization	2,288,892	2,227,627
Other non-operating revenues	11,753	25,546
Other non-operating expenses	(29,397)	(27,568)
Changes in assets and liabilities:		
(Increase)decrease in assets:		
Accounts receivable – sewerage services	(120,824)	42,396
Accounts receivable – governmental agencies	(263,931)	103,739
Accounts receivable – other	(16,295)	(230,123)
Prepaid expenses and other deposits	(58,849)	15,832
Increase(decrease) in liabilities:		
Accounts payable and accrued expenses	(756,020)	(667,741)
Customer deposits and deferred revenue	(80,294)	(175,053)
Restricted – special assessment payable	612	(1,871)
Compensated absences	(52,462)	51,551
Other post-employment benefits payable	283,236	-
Total adjustments	<u>1,206,421</u>	<u>1,364,335</u>
Net cash provided by operating activities	<u>\$ <u>3,334,793</u></u>	<u><u>4,399,466</u></u>

See accompanying notes to the basic financial statements

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Novato Sanitary District
Notes to the Financial Statements
For the Fiscal Years Ended June 30, 2010 and 2009

(1) Reporting Entity and Summary of Significant Accounting Policies

A. Organization and Operations of the Reporting Entity

The Novato Sanitary District (District) is a separate governmental unit established as a Special District of the State of California, created in 1925. The District provides sewage collection, treatment, reclamation, and disposal services to an area of about 21 square miles in and around the City of Novato in Marin County, California. Revenues are derived principally from sewer service charges collected from commercial and residential customers within the District's service area. The District is governed by a five-member Board of Directors who serves four year terms.

B. Basis of Accounting and Measurement Focus

The District reports its activities as an enterprise fund, which is used to account for operations that are financed and operated in a manner similar to a private business enterprise, where the intent of the District is that the costs of providing wastewater service, treatment and collection to its service area on a continuing basis be financed or recovered primarily through user charges (sewer service charges), capital grants and similar funding. Revenues and expenses are recognized on the full accrual basis of accounting. Revenues are recognized in the accounting period in which they are earned and expenses are recognized in the period incurred, regardless of when the related cash flows take place.

Operating revenues and expenses, such as sewer service charges as well as treatment and collection charges, result from exchange transactions associated with the principal activity of the District. Exchange transactions are those in which each party receives and gives up essentially equal values. Management, administration and depreciation expenses are also considered operating expenses. Other revenues and expenses not included in the above categories are reported as non-operating revenues and expenses.

C. Financial Reporting

The District's basic financial statements are presented in conformance with the provisions of Governmental Accounting Standards Board (GASB) Statement No. 34, "*Basic Financial Statements – and Management's Discussion and Analysis – for State and Local Governments*" (GASB No. 34). This statement established revised financial reporting requirements for state and local governments throughout the United States for the purpose of enhancing the understandability and usefulness of financial reports.

GASB No. 34 and its related GASB pronouncements provide for a revised view of financial information and restructure the format of financial information provided prior to its adoption. A statement of net assets replaces the balance sheet and reports assets, liabilities, and the difference between them as net assets, not equity. A statement of revenues, expenses and changes in net assets replaces both the income statement and the statement of changes in retained earnings and contributed capital. GASB No. 34 also requires that the statement of cash flows be prepared using the direct method. Under the direct method, cash flows from operating activities are presented by major categories.

Under GASB No. 34, enterprise funds, such as the District, have the option of consistently following or not following pronouncements issued by the Financial Accounting Standards Board (FASB) subsequent to November 30, 1989. The District has elected not to follow FASB standards issued after that date, unless such standards are specifically adopted by GASB.

Novato Sanitary District
Notes to the Financial Statements
For the Fiscal Years Ended June 30, 2010 and 2009

(1) Reporting Entity and Summary of Significant Accounting Policies, continued

D. Assets, Liabilities and Net Assets

1. Use of Estimates

The preparation of the basic financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosures of contingent assets and liabilities at the date of the financial statements and the reported changes in net assets during the reporting period. Actual results could differ from those estimates.

2. Cash and Cash Equivalents

Substantially all of the District's cash is invested in interest bearing accounts. The District considers all highly liquid investments with a maturity of three months or less to be cash equivalents.

3. Investments

Changes in fair value that occur during a fiscal year are recognized as investment income reported for that fiscal year. Investment income includes interest earnings, changes in fair value, and any gains or losses realized upon the liquidation or sale of investments.

4. Accounts Receivable and Allowance for Uncollectible Accounts

The District extends credit to customers in the normal course of operations. When management deems customer accounts uncollectible, the District uses the allowance method for the reservation and write-off of those accounts.

5. Property Taxes and Sewer Assessments

The Marin County Assessor's Office assesses all real and personal property within the County each year. The Marin County Tax Collector's Office bills and collects the District's share of property taxes and assessments. The Marin County Treasurer's Office remits current and delinquent property tax collections to the District throughout the year. Property tax in California is levied in accordance with Article 13A of the State Constitution at one percent (1%) of countywide assessed valuations.

Property taxes receivable at year-end are related to property taxes collected by the Marin County which have not been credited to the District's cash balance as of June 30. The property tax calendar is as follows:

Lien date	March 1
Levy date	July 1
Due dates	November 1 and March 1
Collection dates	December 10 and April 10

6. Prepaid Expenses

Certain payments to vendors reflect costs or deposits applicable to future accounting periods and are recorded as prepaid items in the basic financial statements.

7. Deferred Charges

The deferred charges are from issuance costs on the District's loans that will be amortized over the remaining life of the loans.

Novato Sanitary District
Notes to the Financial Statements
For the Fiscal Years Ended June 30, 2010 and 2009

(1) Reporting Entity and Summary of Significant Accounting Policies, continued

D. Assets, Liabilities and Net Assets, continued

8. Capital Assets

Capital assets acquired and/or constructed are capitalized at historical cost. District policy has set the capitalization threshold for reporting capital assets at \$5,000. Contributed assets are recorded at estimated fair market value at the date of donation and/or historical cost. Upon retirement or other disposition of capital assets, the cost and related accumulated depreciation are removed from the respective balances and any gains or losses are recognized. Depreciation is recorded on a straight-line basis over the estimated useful lives of the assets as follows:

- Sewer system improvements – 15 years
- Sewer collection and outfall system – 50 to 100 years
- Buildings and structures – 15 to 50 years
- Sewer facilities equipment – 5 to 35 years
- Equipment – 5 to 35 years

9. Compensated Absences

The District's policy is to permit employees to accumulate earned vacation up to a total of 240 hours during their first 15 years of service and 320 hours after 15 years of service with amounts exceeding the limit being paid out as part of the employee's regular compensation. Upon termination of employment, employees are paid all unused vacation and forfeit any unused sick time unless the employee retires from the District their unused sick leave is counted 100% towards CalPERS service credits.

10. Sewer Service Charges

The majority of sewer service charges are billed annually on the County of Marin's property tax bills.

11. Capital Contributions

Capital contributions represent cash and capital asset additions contributed to the District by property owners, granting agencies or real estate developers desiring services that require capital expenditures or connection to the District's system.

12. Budgetary Policies

The District adopts an annual non-appropriated budget for planning, control, and evaluation purposes. Budgetary control and evaluation are affected by comparisons of actual revenues and expenses with planned revenues and expenses for the period. Encumbrance accounting is not used to account for commitments related to unperformed contracts for construction and services.

13. Net Assets

The financial statements utilize a net assets presentation. Net assets are categorized as follows:

- **Net Investment in Capital Assets** – This component of net assets consists of capital assets, net of accumulated depreciation and reduced by any outstanding debt against the acquisition, construction or improvement of those assets.
- **Restricted Net Assets** – This component of net assets consists of constraints placed on net assets use through external constraints imposed by creditors, grantors, contributors, or laws or regulations of other governments or constraints imposed by law through constitutional provisions or enabling legislation.
- **Unrestricted Net Assets** – This component of net assets consists of net assets that do not meet the definition of *restricted* or *net investment in capital assets*.

Novato Sanitary District
Notes to the Financial Statements
For the Fiscal Years Ended June 30, 2010 and 2009

(2) Prior Period Adjustments

	2009	2008
Net assets – end of year –as previously stated	\$ 118,026,556	113,375,768
Adjustment for accumulated depreciation	(11,260,923)	(11,260,923)
Adjustment for overstatement of depreciation expense	1,243,040	-
Adjustment for depreciation expense	(464,991)	-
Adjustment for accrued interest payable	(885,628)	(56,399)
Adjustment to capitalize interest expense	885,628	56,399
Total prior period adjustments	(10,482,874)	(11,260,923)
Change in net assets as of June 30, 2009	-	5,428,837
Net assets – as adjusted and restated	\$ 107,543,682	107,543,682

Adjustment for Accumulated Depreciation

In 2010, it was noted that the District in fiscal years 1984 to 1986 constructed a \$44 million sewer collection and outfall system which included improvements for the Novato and Ignacio treatment plant, Bahia interceptor pump station and reclamation. According to GASB No. 34, *Basic Financial Statements – and Management Discussion and Analysis – for State and Local Governments* (issued June 1999) – Capital assets should be depreciated over their estimated useful lives unless they have inexhaustible and/or have indefinite useful lives, such as land. Prior to fiscal year 2010, the District was not depreciating its sewer collection and outfall system. The District’s sewer collection and outfall system was determined to have a 100 year useful life. Therefore, in fiscal year 2010 the District calculated the past depreciation expense on the sewer collection and outfall system for the past 25-years (1984 to 2009) to be \$11,260,923, which is reflected as a prior period adjustment on the statement of revenues, expenses and changes in net assets.

Adjustment for Overstatement of Depreciation Expense

In 2009, the District overstated depreciation expense in the amount of \$1,243,040 to depreciate the District’s sewer collection and outfall system constructed in fiscal years 1984 to 1986. Since the District has decided to record the \$11,260,923 prior period adjustment, the \$1,243,040 overstatement of depreciation expense related to the prior year will not be required and is being reversed on the statement of revenues, expenses and changes in net assets.

Adjustment for Depreciation Expense

In 2009, the District recorded \$464,991 as depreciation expense for the sewer collection and outfall system based on the 100 year useful life of the system on the statement of revenues, expenses and changes in net assets.

Adjustment for Accrued Interest Payable

In 2010, it was noted that the District was not recording interest expense on the State Water Resources Control Board – State Revolving Fund loan program loan that the District received funding from in fiscal years 2009 and 2008. As the State Revolving Fund loan program funds are received, interest expense on those funds accrues in each period to match the amount of State Revolving Fund loan program funds that have been cumulatively received until the construction project is completed. Therefore, the District is accruing interest payable and interest expense on the financial statements.

Adjustment to Capitalize Interest Expense

The costs of a capital asset during the construction period includes ancillary charges necessary to place the asset in its intended location and condition for use. When a governmental organization uses debt to finance the construction of a capital asset, one of these capitalizable ancillary charges is the interest expense incurred during the construction process. This adjustment is being made to correctly capitalize the interest expense incurred from the State Revolving Fund loan program funds during the construction phase of the District’s new wastewater treatment plant into construction-in-process on the statement of net assets.

Novato Sanitary District
Notes to the Financial Statements
For the Fiscal Years Ended June 30, 2010 and 2009

(3) Cash and Investments

Cash and cash equivalents as of June 30, are classified in the accompanying financial statements as follows:

	<u>2010</u>	<u>2009</u>
Cash and cash equivalents	\$ 10,997,695	32,661,934
Restricted – cash and cash equivalents	167,132	166,520
Total	<u>\$ 11,164,827</u>	<u>32,828,454</u>

Cash and cash equivalents as of June 30, consist of the following:

	<u>2010</u>	<u>2009</u>
Cash on hand	\$ 965	491
Deposits held with financial institutions	6,156	95,862
Deposits held with California Local Agency Investment Fund	11,157,706	32,732,101
Total	<u>\$ 11,164,827</u>	<u>32,828,454</u>

As of June 30, the LAIF investment pool had the following investment turn-over maturities::

	<u>2010</u>	<u>2009</u>
Deposits held with the California Local Agency Investment Fund	203 days	235 days

Investments Authorized by the California Government Code and the District's Investment Policy

The table below identifies the investment types that are authorized by the District in accordance with the California Government Code (or the District's investment policy, where more restrictive). The table also identifies certain provisions of the California Government Code (or the District's investment policy, where more restrictive) that address interest rate risk, credit risk, and concentration of credit risk.

<u>Authorized Investment Type</u>	<u>Maximum Maturity</u>	<u>Maximum Percentage of Portfolio</u>	<u>Maximum Investment in One Issuer</u>
State and local agency bonds, notes and warrants	5 years	None	None
Registered State bonds, noted and warrants	5 years	None	None
U.S. treasury obligations	5 years	None	None
Federal agency securities	5 years	None	None
Banker's acceptances	270 days	40%	30%
Prime commercial paper	180 days	25%	10%
Negotiable certificates of deposit	5 years	30%	None
Repurchase agreements	1 year	None	None
Reverse repurchase agreements	92/30 days	20% of base	None
Medium-term notes	5 years	30%	None
Money market mutual funds	N/A	15%	10%
Mortgage pass-through securities	N/A	30%	None
California Local Agency Investment Fund (LAIF)	N/A	None	None
Passbook savings account demand deposits	N/A	None	None

Investment in State Investment Pool

The District is a voluntary participant in the Local Agency Investment Fund (LAIF) that is regulated by the California Government Code under the oversight of the Treasurer of the State of California. The fair value of the District's investment in this pool is reported in the accompanying financial statements at amounts based upon the District's pro-rata share of the fair value provided by LAIF for the entire LAIF portfolio (in relation to the amortized cost of that portfolio). The balance available for withdrawal is based on the accounting records maintained by LAIF, which are recorded on an amortized cost basis.

Novato Sanitary District
Notes to the Financial Statements
For the Fiscal Years Ended June 30, 2010 and 2009

(3) Cash and Investments

Custodial Credit Risk

Custodial credit risk for *deposits* is the risk that, in the event of the failure of a depository financial institution, a government will not be able to recover its deposits or will not be able to recover collateral securities that are in the possession of an outside party. The California Government Code and the District's investment policy does not contain legal or policy requirements that would limit the exposure to custodial credit risk for deposits, other than the following provision for deposits:

The California Government Code requires that a financial institution secure deposits made by state or local governmental units by pledging securities in an undivided collateral pool held by a depository regulated under state law (unless so waived by the governmental unit). The market value of the pledged securities in the collateral pool must equal at least 110% of the total amount deposited by the public agencies. Of the bank balances, up to \$250,000 at June 30, 2010 and 2009 is federally insured and the remaining balance is collateralized in accordance with the Code; however, the collateralized securities are not held in the District's name.

The custodial credit risk for *investments* is the risk that, in the event of the failure of the counterparty (e.g., broker-dealer) to a transaction, a government will not be able to recover the value of its investment or collateral securities that are in the possession of another party. The Code and the District's investment policy contains legal and policy requirements that would limit the exposure to custodial credit risk for investments. With respect to investments, custodial credit risk generally applies only to direct investments in marketable securities. Custodial credit risk does not apply to a local government's indirect investment in securities through the use of mutual funds or government investment pools (such as LAIF).

Interest Rate Risk

Interest rate risk is the risk that changes in market interest rates will adversely affect the fair value of an investment. Generally, the longer the maturity of an investment the greater the sensitivity of its fair value to changes in market interest rates. One of the ways that the District manages its exposure to interest rate risk is by purchasing a combination of shorter term and longer term investments and by timing cash flows from maturities so that a portion of the portfolio matures or comes close to maturity evenly over time as necessary to provide for cash flow requirements and liquidity needed for operations.

Credit Risk

Credit risk is the risk that an issuer of an investment will not fulfill its obligation to the holder of the investment. This is measured by the assignment of a rating by a nationally recognized statistical rating organization.

Concentration of Credit Risk

The District's investment policy contains no limitations on the amounts that can be invested in any one issuer as beyond that stipulated by the California Government Code. There were no investments in any one issuer that represent 5% or more of total District's investments at June 30, 2010 and 2009, respectively.

Novato Sanitary District
Notes to the Financial Statements
For the Fiscal Years Ended June 30, 2010 and 2009

(4) Deferred Charges

Deferred charges relate to the issuance costs of the District's note payable and are being amortized over the length of the debt service.

The balance at June 30, consists of the following:

	2010	2009
Deferred charges	\$ 91,500	91,500
Accumulated amortization	(74,756)	(56,067)
Deferred charges, net	\$ 16,744	35,433

(5) Capital Assets

Changes in capital assets for the year were as follows:

	Balance 2009	Additions/	Deletions/ Transfers	Balance 2010
Non-depreciable assets:				
Land and land rights	\$ 2,774,742	-	-	2,774,742
Easements	1,617,174	-	-	1,617,174
Construction-in-process	55,791,974	27,815,084	(3,308,336)	80,298,722
Total non-depreciable assets	60,183,890	27,815,084	(3,308,336)	84,690,638
Depreciable assets:				
Sewer system improvements	52,576,263	311,334	-	52,887,597
Sewer collection and outfall system	45,771,394	724,595	-	46,495,989
Buildings and structures	25,287,498	3,177,018	(1,270,836)	27,193,680
Sewer facilities equipment	12,102,468	35,999	(23,358)	12,115,109
Equipment	1,768,551	25,372	(24,037)	1,769,886
Total depreciable assets	137,506,174	4,274,318	(1,318,231)	140,462,261
Accumulated depreciation:				
Sewer system improvements	(14,542,711)	(946,385)	-	(15,489,096)
Sewer collection and outfall system	(11,725,914)	(479,483)	-	(12,205,397)
Buildings and structures	(5,251,759)	(321,971)	361,283	(5,212,447)
Sewer facilities equipment	(8,342,700)	(434,781)	23,358	(8,754,123)
Equipment	(763,172)	(106,272)	24,037	(845,407)
Total accumulated depreciation	(40,626,256)	(2,288,892)	408,678	(42,506,470)
Total depreciable assets, net	96,879,918	1,985,426	(909,553)	97,955,791
Total capital assets, net	\$ 157,063,808	29,800,510	(4,217,889)	182,646,429

Major capital assets additions during the year include construction of the District's new wastewater treatment plant and other buildings, structures and improvements.

Novato Sanitary District
Notes to the Financial Statements
For the Fiscal Years Ended June 30, 2010 and 2009

(5) Capital Assets, continued

Changes in capital assets for the year were as follows:

	<u>Balance 2008</u>	<u>Additions/</u>	<u>Deletions/ Transfers</u>	<u>Balance 2009</u>
Non-depreciable assets:				
Land and land rights	\$ 2,774,742	-	-	2,774,742
Easements	1,570,418	46,756	-	1,617,174
Construction-in-process	22,268,880	34,338,301	(815,207)	55,791,974
Total non-depreciable assets	<u>26,614,040</u>	<u>34,385,057</u>	<u>(815,207)</u>	<u>60,183,890</u>
Depreciable assets:				
Sewer system improvements	52,576,263	-	-	52,576,263
Sewer collection and outfall system	45,043,692	727,702	-	45,771,394
Buildings and structures	24,505,875	781,623	-	25,287,498
Sewer facilities equipment	12,305,811	28,188	(231,531)	12,102,468
Equipment	1,767,981	73,709	(73,139)	1,768,551
Total depreciable assets	<u>136,199,622</u>	<u>1,611,222</u>	<u>(304,670)</u>	<u>137,506,174</u>
Accumulated depreciation:				
Sewer system improvements	(13,617,594)	(925,117)	-	(14,542,711)
Sewer collection and outfall system	(11,260,923)	(464,991)	-	(11,725,914)
Buildings and structures	(4,950,618)	(301,141)	-	(5,251,759)
Sewer facilities equipment	(8,058,325)	(435,857)	151,482	(8,342,700)
Equipment	(731,997)	(100,521)	69,346	(763,172)
Total accumulated depreciation	<u>(38,619,457)</u>	<u>(2,227,627)</u>	<u>220,828</u>	<u>(40,626,256)</u>
Total depreciable assets, net	<u>97,580,165</u>	<u>(616,405)</u>	<u>(83,842)</u>	<u>96,879,918</u>
Total capital assets, net	\$ <u>124,194,205</u>	<u>33,768,652</u>	<u>(899,049)</u>	<u>157,063,808</u>

Major capital assets additions during the year include construction of the District's new wastewater treatment plant and other buildings, structures and improvements.

Construction-In-Process

The District is involved in various construction projects throughout the year. Once completed, projects are capitalized and depreciated over the life of the asset.

Construction-in-process consists of the following projects as of June 30:

<u>Projects</u>	<u>2008</u>	<u>2009</u>	<u>2010</u>
Wastewater treatment plant upgrade	\$ 21,339,885	52,887,332	77,056,798
BMK pump station rehabilitation	199,073	2,282,605	-
Collection system improvements	-	-	1,752,633
Pump station rehabilitation	-	-	783,108
North Bay Water Reuse Authority	261,674	331,043	395,272
SCADA system improvements	190,554	191,223	201,450
NTP soil and groundwater project	84,628	91,846	100,273
Various other minor projects >\$50,000	193,066	7,925	9,188
Total	<u>\$ 22,268,880</u>	<u>55,791,974</u>	<u>80,298,722</u>

Novato Sanitary District
Notes to the Financial Statements
For the Fiscal Years Ended June 30, 2010 and 2009

(6) Compensated Absences

The changes to compensated absences balances at June 30, were as follows:

<u>Balance</u> <u>2009</u>	<u>Additions</u>	<u>Deletions</u>	<u>Balance</u> <u>2010</u>	<u>Due Within</u> <u>One Year</u>
\$ 222,195	132,546	(185,008)	169,733	42,433
<u>Balance</u> <u>2008</u>	<u>Additions</u>	<u>Deletions</u>	<u>Balance</u> <u>2009</u>	<u>Due Within</u> <u>One Year</u>
\$ 170,644	136,258	(84,707)	222,195	55,549

(7) Long-Term Debt

Changes in long-term debt amounts for 2010 were as follows:

	<u>Balance</u> <u>2009</u>	<u>Additions</u>	<u>Deletions</u>	<u>Balance</u> <u>2010</u>
Long-term debt:				
Note payable	\$ 30,006,231	-	(24,773,024)	5,233,207
Loan payable	47,989,587	27,358,620	-	75,348,207
Total long-term debt	\$ 77,995,818	27,358,620	(24,773,024)	80,581,414

Changes in long-term debt amounts for 2009 were as follows:

	<u>Balance</u> <u>2008</u>	<u>Additions</u>	<u>Deletions</u>	<u>Balance</u> <u>2009</u>
Long-term debt:				
Note payable	\$ 30,006,231	-	-	30,006,231
Loan payable	21,691,826	26,297,761	-	47,989,587
Total long-term debt	\$ 51,698,057	26,297,761	-	77,995,818

Note Payable – Revolving Credit Line

On May 10, 2006, the District secured a revolving credit line with Zions National Bank. Under the terms of the agreement for the revolving credit line the District may borrow up to \$30 million to provide interim financing for the acquisition and construction of improvements to the wastewater collection, treatment, and disposal facilities of the District. The District has applied for and has received a loan from the California State Water Resources Control Board's State Revolving Fund (SRF) loan program to provide long-term financing for the construction projects noted above. The District's long-term financing plan calls for the repayment of the revolving credit line obligation from the proceeds of the SRF loan program or from other long-term financing arrangements.

The revolving credit line is secured by a pledge of and lien against the net revenues of the District's wastewater system. The maturity date of the revolving credit line obligation is April 1, 2011. The revolving credit line obligation accrues interest at a variable rate, defined in the agreement as a rate of interest equal to 85% of the one-year Seattle Federal Home Loan Bank rate which was 0.75% as of June 30, 2010. Interest is payable semi-annually on October 1 and April 1. The outstanding note payable balance of \$5,233,207 is expected to be repaid by the District on or before April 1, 2011.

Novato Sanitary District
Notes to the Financial Statements
For the Fiscal Years Ended June 30, 2010 and 2009

(7) Long-Term Debt, continued

Loan Payable – State Water Resources Control Board Loan

In fiscal year 2008, the District was granted a loan for \$81,329,083 from the California State Water Resources Control Board under the State Revolving Fund (SRF) loan program to upgrade and expand the Novato Treatment Plant to treat the combined flow of the District's wastewater treatment plants. The funds received are Federal funding provided to the State of California under the Federal Clean Water Act.

The District constructed the Ignacio Transfer Pump Station at the site of the Ignacio Treatment Plant along with the Ignacio Conveyance Force Main to convey flow from the Ignacio Transfer Pump Station to the Novato Treatment Plant. Upon completion of the upgrade to the Novato Treatment Plant, the Ignacio Treatment Plant will be phased out of service and flows from the Ignacio Plant will be pumped to the Novato Plant for treatment.

As of June 30, 2010, the District has received \$72,720,776 and has requested another \$2,627,431 for a total of \$75,348,207 from the SRF loan program. Interest accrues on the obligation at a rate of 2.40% compounded annually. As of June 30, 2010, interest expense on the SRF loan has accrued to the amount of \$2,379,107. The first debt service payment is due on December 15, 2011 and each December 15th thereafter through fiscal year 2031. The following table summarizes the debt service maturity of the District for this loan as follows:

<u>Fiscal Year</u>	<u>Principal</u>	<u>Interest</u>	<u>Total</u>
2011	\$ -	-	-
2012	-	6,064,321	6,064,321
2013	3,471,166	1,951,898	5,423,064
2014	3,554,474	1,868,590	5,423,064
2015	3,639,781	1,783,282	5,423,063
2016-2020	19,551,919	7,563,400	27,115,319
2021-2025	22,013,505	5,101,814	27,115,319
2026-2030	24,785,001	2,330,318	27,115,319
2031	4,313,237	103,518	4,416,755
Total	\$ 81,329,083	26,767,141	108,096,224
Remaining draws	<u>(5,980,876)</u>		
Loan payable	\$ <u>75,348,207</u>		

Novato Sanitary District
Notes to the Financial Statements
For the Fiscal Years Ended June 30, 2010 and 2009

(8) Post Employment Benefits Payable

During the fiscal year ended June 30, 2010, the District implemented GASB Statement No. 45, which changed the accounting and financial reporting used by local government employers for post employment benefits. Previously, the costs of such benefits were generally recognized as expenses of local government employers on a pay-as-you-go basis. The new reporting requirements for these benefit programs as they pertain to the District are set forth below.

Plan Description – Eligibility

The District pays a portion of the cost of health insurance for retirees under any group plan offered by CalPERS, subject to certain restrictions as determined by the District.

Membership in the OPEB plan consisted of the following members as of June 30:

	<u>2010</u>	<u>2009</u>	<u>2008</u>
Active plan members	25	31	32
Retirees and beneficiaries receiving benefits	22	18	19
Separated plan members entitled to but not yet receiving benefits	-	-	-
Total plan membership	<u>47</u>	<u>49</u>	<u>51</u>

Plan Description – Benefits

The District offers post employment medical benefits to retired employees who satisfy the eligibility rules. Spouses, surviving spouses and eligible dependents are also eligible to receive benefits. Retirees may enroll in any plan available through the District's CalPERS medical plan. The contribution requirements of Plan members and the District are established and may be amended by the Board of Directors.

Funding Policy

The District is required to contribute the *Annual Required Contribution (ARC) of the Employer*, an amount actuarially determined in accordance with the parameters of GASB Statement No. 45. The ARC represents a level of funding that, if paid on an ongoing basis, is projected to cover the normal cost each year and amortize any unfunded actuarial liabilities (or funding excess) over a period not to exceed thirty years. The current ARC rate is 20.0% of the annual covered payroll.

The District will pay 100% of the cost of the post-employment benefit plan. The District funds the plan on a pay-as-you-go basis and maintains reserves (and records a liability) for the difference between pay-as-you-go and the actuarially determined ARC cost.

Novato Sanitary District
Notes to the Financial Statements
For the Fiscal Years Ended June 30, 2010 and 2009

(8) Post Employment Benefits Payable, continued

Annual Cost

For the year ended June 30, 2010, the District's ARC cost is \$473,000. The District's net OPEB payable obligation amounted to \$283,236 for the year ended June 30, 2010. The District contributed \$189,764 in age adjusted contributions for current retiree OPEB premiums for the year ended June 30, 2010.

The balance at June 30, consists of the following:	<u>2010</u>	<u>2009</u>	<u>2008</u>
Annual OPEB expense:			
Annual required contribution (ARC)	\$ 473,000	-	-
Interest on net OPEB obligation	-	-	-
Adjustment to annual required contribution	-	-	-
Total annual OPEB expense	<u>473,000</u>	-	-
Change in net OPEB payable obligation:			
Age adjusted contributions made	<u>(189,764)</u>	-	-
Total change in net OPEB payable obligation	<u>283,236</u>	-	-
OPEB payable – beginning of year	-	-	-
OPEB payable – end of year	<u>\$ 283,236</u>	<u>-</u>	<u>-</u>

The District's annual OPEB cost, the percentage of the annual OPEB cost contributed to the Plan, and the net OPEB obligation for fiscal year 2010 and the two preceding years were as follows:

<i>Three-Year History of Net OPEB Obligation</i>				
<u>Fiscal Year Ended</u>	<u>Annual OPEB Cost</u>	<u>Age Adjusted Contribution</u>	<u>Percentage of Annual OPEB Cost Contributed</u>	<u>Net OPEB Obligation Payable</u>
2010	\$ 473,000	189,764	40.12%	\$ 283,236
2009	*	-	0.00%	-
2008	*	-	0.00%	-

* The information for this year is unavailable.
GASB No. 45 was implemented in fiscal year 2010.

Novato Sanitary District
Notes to the Financial Statements
For the Fiscal Years Ended June 30, 2010 and 2009

(8) Post Employment Benefits Payable, continued

Funded Status and Funding Progress of the Plan

Required Supplemental Information – Schedule of Funding Progress

Actuarial Valuation Date	Actuarial Value of Plan Assets (a)	Actuarial Accrued Liability (b)	Unfunded Actuarial Accrued Liability (UAAL) (b-a)	Funded Ratio (a/b)	Covered Payroll (c)	UAAL as a Percentage of Covered Payroll ((b-a)/c)
7/1/2009	\$ -	5,554,000	5,554,000	0.00%	\$ 2,350,000	236.34%

The most recent valuation (dated July 1, 2009) includes an Actuarial Accrued Liability and Unfunded Actuarial Accrued Liability of \$5,554,000. There are no plan assets because the District funds on a pay-as-you-go basis. No trend information is reported because the year ended June 30, 2010, is the first year the District implemented GASB 45. The covered payroll (annual payroll of active employees covered by the plan) for the year ended June 30, 2010 was \$2,350,000. The ratio of the unfunded actuarial accrued liability to annual covered payroll is 236.34%.

Actuarial Methods and Assumptions

Actuarial valuations involve estimates of the value of reported amounts and assumptions about the probability of events far into the future. Actuarially determined amounts are subject to continual revision as actual results are compared to past expectations and new estimates are made about the future. Calculations are based on the types of benefits provided under the terms of the substantive plan at the time of each valuation and the pattern of sharing of costs between the employer and plan members to that point. Consistent with the long-term perspective of actuarial calculations, actuarial methods and assumptions used include techniques that are designed to reduce short-term volatility in actuarial accrued liabilities for benefits.

The following is a summary of the actuarial assumptions and methods:

Valuation date	July 1, 2009
Actuarial cost method	Entry age normal cost method
Amortization method	Level percent of payroll amortization
Remaining amortization period	30 Years as of the valuation date
Asset valuation method	30 Year smoothed market
Actuarial assumptions:	
Discount rate	4.00%
Projected salary increase	District expected COLA
Inflation - discount rate	4.00%

Novato Sanitary District
Notes to the Financial Statements
For the Fiscal Years Ended June 30, 2010 and 2009

(9) Net Assets

Calculation of net assets as of June 30, were as follows:

	2010	2009
Net investment in capital assets:		
Capital assets – not being depreciated	\$ 84,690,638	60,183,890
Capital assets, net – being depreciated	97,955,791	96,879,918
Note payable	(5,233,207)	(30,006,231)
Loan payable	(75,348,207)	(47,989,587)
Total net investment in capital assets	102,065,015	79,067,990
Unrestricted net assets:		
Non-spendable net assets:		
Prepaid expenses and deposits	58,849	-
Deferred charges, net	16,744	35,433
Total non-spendable net assets	75,593	35,433
Spendable net assets are designated as follows:		
Undesignated net assets reserve	9,205,689	28,440,259
Total spendable net assets	9,205,689	28,440,259
Total unrestricted net assets	9,281,282	28,475,692
Total net assets	\$ 111,346,297	107,543,682

(10) Property Taxes and Sale of a Receivable

Under the provisions of the State of California Proposition 1A and as part of the 2010 fiscal year State of California budget package passed by the California State Legislature on July 28, 2009, the State of California borrowed 8.0% of the amount of property tax revenue apportioned to cities, counties and special districts. The State of California is required to repay this borrowing plus interest by June 30, 2013. After repayment of this initial borrowing, the California State Legislature may consider only one additional borrowing within a ten-year period. The amount of the borrowing pertaining to the District was \$140,065.

Authorized with the 2010 fiscal year State of California budget package, the State of California Proposition 1A Securitization Program (Securitization Program) was instituted by the California Statewide Communities Development Authority (California Communities), a joint-powers authority sponsored by the California State Association of Counties and the League of California Cities, to enable local governments to sell their State of California Proposition 1A receivables to California Communities. Under the Securitization Program, California Communities simultaneously purchased the State of California Proposition 1A receivables and issued bonds (Prop 1A Bonds) to provide California local governmental agencies with cash proceeds in two equal installments, on January 15, 2010 and May 3, 2010. The purchase price paid to the California local governmental agencies equaled 100% of the amount of the property tax reduction. All transaction costs of the issuance and interest were paid by the State of California. Participating California local governmental agencies have no obligation on the bonds and no credit exposure to the State of California. The District participated in the Securitization Program and accordingly property tax revenue has been recorded in the same manner as if the State of California had not exercised its rights under State of California Proposition 1A. The receivable sale proceeds were equal to the book value of the property tax reduction for each agency and, as a result, no gain or loss was recorded to recognize these proceeds.

Novato Sanitary District
Notes to the Financial Statements
For the Fiscal Years Ended June 30, 2010 and 2009

(11) Deferred Compensation Savings Plan

The District's employees may participate in two 457 Deferred Compensation Programs (Programs). The Programs are available to all District employees and is entirely voluntary. The purpose of these Programs is to provide deferred compensation for public employees that elect to participate in these Programs. Generally, eligible employees may defer receipt of a portion of their salary until termination, retirement, death or unforeseeable emergency. Until the funds are paid or otherwise made available to the employee, the employee is not obligated to report the deferred salary for income tax purposes. The District makes no matching contributions to the Programs.

Federal law requires deferred compensation assets to be held in trust for the exclusive benefit of the participants. Accordingly, the District is in compliance with this legislation. Therefore, these assets are not the legal property of the District, and are not subject to claims of the District's general creditors. Market value of all Program assets held in trust by the District's two deferred compensation programs at June 30, 2010 and 2009 amounted to \$1,986,895 and \$1,841,922, respectively.

The District has implemented GASB Statement No. 32, *Accounting and Financial Reporting for Internal Revenue Code Section 457 Deferred Compensation Plans*. Since the District has little administrative involvement and does not perform the investing function for this plan, the assets and related liabilities are not shown on the statement of net assets.

The District also offers a 401(a) Plan (Plan) to management and confidential employees. The District contributes 2.5% of base salary for all qualified employees, with the exception of the Manager-Engineer. The District's contribution for the Manager-Engineer is equivalent to the maximum of a 457 plans annual contribution. Employees contributions to this Plan are mandatory for qualified employees. Market value of all Plan assets held in trust by the District's 401(a) Plan at June 30, 2010 amounted to \$202,058.

(12) Defined Benefit Pension Plan

Plan Description

The Agency contributes to the California Public Employees Retirement System (CalPERS), a cost-sharing multi-employer defined benefit pension plan. CalPERS provides retirement and disability benefits, annual cost-of-living adjustments, and death benefits to plan members and beneficiaries. CalPERS acts as a common investment and administrative agent for participating public agencies within the State of California. Benefit provisions and all other requirements are established by state statute and the Agency. Copies of CalPERS annual financial report may be obtained from their executive Office: 400 P Street, Sacramento, CA, 95814.

Funding Policy

The contribution rate for plan members in the CalPERS, 2.0% at 55 Risk Pool Retirement Plan is 7% of their annual covered salary and is paid by the District. The District makes these contributions required of District employees on their behalf and for their account. Also, the District is required to contribute the actuarially determined remaining amounts necessary to fund the benefits for its members. The required employer contribution rates are equal to the annual pension costs (APC) percentage of payroll for fiscal years 2010, 2009 and 2008 as noted below. The contribution requirements of the plan members are established by State statute, and the employer contribution rate is established and may be amended by CalPERS. For Fiscal years 2010, 2009 and 2008, the District's annual contributions for the CalPERS plan were equal to the Agencies required and actual contributions for each fiscal year as follows:

Three Year Trend Information:

<u>Fiscal Year</u>	<u>Annual Pension Cost (APC)</u>	<u>Percentage of APC Contributed</u>	<u>Net Pension Obligation</u>	<u>APC Percentage of Payroll</u>
2007-2008	\$ 331,736	100%	-	12.794%
2008-2009	330,422	100%	-	12.430%
2009-2010	301,129	100%	-	13.033%

Novato Sanitary District
Notes to the Financial Statements
For the Fiscal Years Ended June 30, 2010 and 2009

(13) Risk Management

The District is exposed to various risks of loss related to torts; theft of, damage to, and destruction of assets; errors and omissions; injuries to employees; and natural disasters. The District is a member of the California Sanitation Risk Management Authority (CSRMA), an intergovernmental risk sharing joint powers authority currently operating as a common risk management and loss prevention program for 60 California sanitation districts. The District pays an annual premium to CSRMA for its public liability and workers compensation risk coverage. The Agreement for formation of the CSRMA provides that CSRMA will be self-sustaining through member premiums and will provide specific excess insurance through commercial companies. The CSRMA is allowed to make additional assessments to its members based on a retrospective premium adjustment process. At June 30, 2010, the District participated in the self-insurance programs of the CSRMA as follows:

- General and automotive liability, including errors and omissions and employment practices liability (EPL): The District is self-insured through the CSRMA up to \$750,000 with a \$25,000 deductible (\$25,000 for EPL, \$25,000 for sewer backup, and \$2,500 for E&O) per occurrence. Re-insurance is purchased above the \$750,000 self-insured layer to \$15,750,000 through CSRMA.
- Workers' compensation and employer's liability: The District is self-insured through the CSRMA up to \$750,000 with a deductible of \$0 per claim. The District purchased through CSRMA, additional excess workers' compensation coverage and excess employer's liability coverage of \$1,000,000.

In addition to the above, the District also has the following insurance coverage:

- Employee dishonesty coverage up to \$1,000,000 per loss includes public employee dishonesty, forgery or alteration, theft, computer fraud, and faithful performance coverage with a deductible of \$1,000 per claim.
- Special form property coverage up to \$62,749,159 with a deductible of \$25,000 per claim.
- Public entity physical damage up to \$1,408,089 total value, with a \$2,000/\$5,000 deductible.

Settled claims have not exceeded any of the coverage amounts in any of the last three fiscal years and there were no reductions in the District's insurance coverage during the years ending June 30, 2010, 2009 and 2008. Liabilities are recorded when it is probable that a loss has been incurred and the amount of the loss can be reasonably estimated net of the respective insurance coverage. Liabilities include an amount for claims that have been incurred but not reported (IBNR). There were no IBNR claims payable as of June 30, 2010, 2009 and 2008.

(14) Commitments and Contingencies

Local Improvement District Bonds

Within the District's boundaries, there exists Assessment District No. 2001 (Novato Heights) which was formed for the sole purpose of financing sewer system improvements. The District is not liable for repayment of any bonds issued to finance these local improvements. The District acts as the agent for the property owners within the assessment district by collecting assessments, forwarding collections to bondholders, and initiating foreclosure procedures if appropriate. The outstanding balance on these bonds was \$1,525,000, as of June 30, 2010.

Novato Sanitary District
Notes to the Financial Statements
For the Fiscal Years Ended June 30, 2010 and 2009

(14) Commitments and Contingencies, continued

Construction Contracts

The District has a variety of agreements with developers and private parties relating to the installation, improvement or modification of transmission facilities and distribution systems within its service area. The financing of such improvements is provided primarily from advances for construction and the districts capital replacement reserve. The District has committed to approximately \$6,437,165 of open construction contracts as of June 30, 2010.

Grant Awards

Grant funds received by the District are subject to audit by the grantor agencies. Such audits could lead to requests for reimbursements to the grantor agencies for expenditures disallowed under terms of the grant. Management of the District believes that such disallowances, if any, would not be significant.

Litigation

In the ordinary course of operations, the District is subject to claims and litigation from outside parties. After consultation with legal counsel, the District believes the ultimate outcome of such matters, if any, will not materially affect its financial condition.

EPA Investigation

In May 2009, the United States Department of Justice and the Environmental Protection Agency (DOJ & EPA) criminal investigators and other agencies made an unannounced visit to the District's Novato facility and served a search warrant upon the District and collected documents concerning an allegation that the District may have committed violations in previous years.

Thereafter, representatives of the DOJ & EPA informed the District that the DOJ & EPA were conducting an investigation and assessing whether to bring enforcement action against the District and several of the District's current and former employees for violations of the federal Clean Water Act. Both criminal and civil enforcement action were being contemplated and the investigation was focused on conduct occurring in 2007.

Also, on March 4, 2010, the California State Water Resources Control Board (SWRCB) enforcement officials conducted an unannounced inspection of the District's Novato facility and interviewed several District employees and employees of the District's contractor, Veolia. The District's understanding is that the focus of the SWRCB's investigative effort may overlap with the DOJ & EPA's investigation.

The District has incurred tremendous legal expenditures to respond to these investigations in fiscal year 2010.

Civil or criminal enforcement arising out of these investigations could result in penalties being assessed against the District. Neither the DOJ & EPA officials nor the SWRCB officials have given any indication of whether they intend to seek such penalties, much less specify any potential amount of an assessment of a penalty, and it is not now possible to predict whether such penalties will be assessed.

(15) Subsequent Events

On August 24, 2010, the Assistant United States Attorney in charge of the DOJ & EPA investigation informed the District's counsel that the DOJ & EPA had decided not to file criminal charges against the District or any of the District's officers or employees and referred the investigation to the SWRCB for any further action. Although no contact has been made by the SWRCB officials with regard to this matter, it is likely that some level of civil penalties will be assessed against the District.

Report on Internal Controls and Compliance

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DRAFT

**Independent Auditor's Report on Internal Controls Over Financial Reporting
And on Compliance and Other Matters Based on an Audit of Financial Statements
Performed in Accordance with *Government Auditing Standards***

Board of Directors
Novato Sanitary District
Novato, California

We have audited the basic financial statements of the Novato Sanitary District (District) as of and for the years ended June 30, 2010 and 2009 and have issued our report thereon dated September 18, 2010. We conducted our audits in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States.

Internal Control Over Financial Reporting

In planning and performing our audits, we considered the District's internal control over financial reporting as a basis for designing our auditing procedures for the purpose of expressing our opinions on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of the District's internal control over financial reporting. Accordingly, we do not express an opinion on the effectiveness of the District's internal control over financial reporting.

A control deficiency exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent or detect misstatements on a timely basis. A significant deficiency is a control deficiency, or combination of control deficiencies, that adversely affects the District's ability to initiate, authorize, record, process, or report financial data reliably in accordance with generally accepted accounting principles such that there is more than a remote likelihood that a misstatement of the District's financial statements that is more than inconsequential will not be prevented or detected by the District's internal control. A material weakness is a significant deficiency, or combination of significant deficiencies, that results in more than a remote likelihood that a material misstatement of the financial statements will not be prevented or detected by the District's internal control. Our consideration of internal control over financial reporting was for the limited purpose described in the first paragraph of this section and would not necessarily identify all deficiencies in internal control that might be significant deficiencies or material weaknesses. We did not identify any deficiencies in internal control over financial reporting that we consider to be material weaknesses, as defined above.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether the District's financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts and grants, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit and, accordingly, we do not express such an opinion. The results of our tests disclosed no instances of noncompliance that are required to be reported under *Government Auditing Standards*.

This report is intended solely for the information and use of the Board of Directors and management and is not intended to be and should not be used by anyone other than these specified parties.

September 18, 2010
Cypress, California